REQUEST FOR PUBLIC COMMENT

The Acquisition Advisory Panel seeks input from the public on the attached proposal.

The attached proposal is a revision to an earlier proposal by Panel Member Marshall Doke. (The original proposal continues to be posted to the Acquisition Advisory Panel website's opening page.) This revision was discussed at the Acquisition Advisory Public Meeting on December 16, 2005. Neither the original or revised proposals have been approved by the Acquisition Advisory Panel or the Panel's Commercial Practices Working Group.

Please submit written public statements per the instructions at this website.

E. Application of Commercial Rules to Government Contracts.

1. Issue. The United States Supreme Court has held for 130 years that the same rules of contract interpretation and performance of contracts are applied both to the Government and contractors. In some important areas, however, the lower courts and the boards of contract appeals have not followed the Supreme Court's holdings and have given the Government more favorable treatment as a contracting party than given to contractors. This favorable treatment is not based on statutory or contractual provisions but, rather, is based on evidentiary presumptions and misapplication of rules applicable to the Government in its sovereign, rather than its contractual, capacity.

2. Analysis. An excellent and scholarly discussion of the history of two of the areas of favored treatment for the Government (the presumptions of regularity and good faith) is contained in Judge Wolski's opinion in *Tecom, Inc. v. United States*, 66 Fed. Cl. 763 (2005). This discussion contains liberal use of the analysis and cases cited in the *Tecom* opinion.

a. Supreme Court Cases.

As early as 1875, the Supreme Court stated that the Government is subject to the same rules as contractors. In *Cooke v. United States*, 91 U.S. 237 (1875), the issue involved the Government's liability on a treasury note. The Court said that, when the United States became parties to commercial papers, they incur all the responsibilities of private persons under the same circumstances. (91 U.S. at 242) The Court then said:

> If [the government] comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there.

(91 U.S. at 243) Two years later, in a case involving the Government's obligations under a lease, the Court said:

> The United States, when they contract with their citizens, are controlled by the same laws that govern the citizen in that behalf. All obligations which would be implied against citizens under the same circumstances will be implied against them.

United States v. Bostwick, 94 U.S. 53, 66 (1877).

In a case involving government insurance, *Lynch v. United States*, 292 U.S. 571, 579 (1934), the Court said:

> When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.

In another case, *Perry v. United States*, 294 U.S. 330, 352 (1935), the Court said:

> When the United States, with constitutional authority, makes contracts, it has rights and incurs responsibilities similar to those of individuals who are parties to such instruments. *There is no difference,* said the Court in *United States v. Bank of the Metropolis,* 15 Pet. 377, 392, 10 L. Ed. 774, except that the United States cannot be sued without its consent . . . .

More recently, in *United States v. Winstar Corp.*, 518 U.S. 839, 895 (1996), the Court's plurality opinion used the language in the *Lynch* case (quoted above) with approval. Later the Court quoted *Winstar* with approval for the same *Lynch* quotation in *Mobile Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604, 607-8 (2000), in a nearly unanimous opinion (and the single dissent of Justice Stevens disagreed only with the remedy, not the breach of contract). Most recently, the Court used the same language in *Franconia Associates v. Unites States*, 536 U.S. 129, 141 (2002).

b. Lower Court Cases.

The lower courts consistently have recited the views of the Supreme Court, as discussed above. The view was stated in the Court of Claims *en banc* opinion in *Torncello, et al. v. United States*, 681 F.2d 756 (Ct. Cl. 1982), in which the court said:

> The government contracts as does a private person, under the broad dictates of the common law. "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Lynch v. United States*, 292 U.S. 571, 579, 54 S.Ct. 840, 843, 78 L.Ed. 1434 (1934); *Perry v. United States*, 294 U.S. 330, 55 S.Ct. 432, 79 L.Ed. 912 (1935). While it is true that the government has the power to abrogate common-law contract doctrines by specific legislation, *see, e.g.*, the First War Powers Act, 1941, Pub.L.No. 77-354, 55 Stat. 838 (power to the President to authorize agencies to enter into contracts "without regard to the provisions of law relating to the making, performance, amendment, or modification of contracts," 55 Stat. 839); U.C.C. § 2-209(1), "Modification, Rescission and Waiver" (contractual modifications within Article 2 do not need consideration), the general rule must be that common-law contract doctrines limit the government's power to contract just as they limit the power of any private person. Thus, the government's entry into the field of contracts is not like its selective creation of rights and entitlements in other fields. As we have explained, statutes and regulations in other fields circumscribe a prospective plaintiff's recovery strictly. If, however, a plaintiff's action or recovery purportedly is limited by a contractual term, that limitation will stand only if allowable under the doctrines of contract. Indeed, the Supreme Court has held as

> early as 1923 that the government may not, by simple contract, reserve to itself a power that exceeds that which a private person may have. *Willard, Sutherland & Co. v. United States*, 262 U.S. 490, 43 S.Ct. 592, 67 L.Ed. 1086 (government may not reserve to itself a right of non-performance without destroying the contract). And it does not matter that a contract term is mandated by federal procurement regulation. In the field of contracts, it is only by specific legislation that the government may trespass the bounds of general contract doctrines. . . .

681 F.2d at 762-3.

Very recently, similar views were expressed by the Fourth Circuit as follows:

> Indeed, the law generally applicable to government contract claims is the same as would be applied in any commercial breach of contract suit. *See Franconia Assocs. V. United States*, 536 U.S. 129, 141 (2002) ("When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." (internal quotation marks omitted)); *United States v. Bankers Ins. Co.*, 245 F.3d 315, 321 (4th Cir. 2001) ("It is well settled that, when the United States is a party to a contract, ordinary principles governing contracts and their interpretation remain applicable.") UK MOD contends that its claims against Trimble are subject to ordinary principles of contract law and neither the Government nor Trimble have demonstrated otherwise. The district court is certainly qualified to apply ordinary principles of contract law to resolve UK MOD's claims against Trimble.

United Kingdom Ministry of Defense v. Trimble Navigation Limited, 422 F.3d 165 (4th Cir. Sept. 6, 2005).

c. Government's More Favorable Treatment.

The courts and boards of contract appeals, in a number of significant circumstances, have not followed the guidance in the Supreme Court and lower court cases discussed above. One reason may be the failure to recognize the distinction between the Government's actions in its sovereign and contractual capacities. In *Horowitz v. United States*, 267 U.S. 458, 459 (1925), the Court quoted from *Jones v. United States*, 1 Ct. Cl. 383, 384, saying that the two characters which the Government possesses as a contractor and as a sovereign cannot be fused. In some cases, as stated in the *Tecom* case, *supra*, the reason for the lower courts' decisions is never satisfactorily explained. 66 Fed. Cl. at 757.

Some rules of contract interpretation, performance, and liability that favor the Government over contractors are inconsistent with the Supreme Court cases discussed above. Examples of such rules and their application are discussed below.

(1) Presumption of Regularity. The presumption of regularity of action of government officials has its historical roots in the presumption against misconduct (particularly regarding sovereign functions). The presumption is discussed exhaustively in the *Tecom* case, 66 Fed. Cl. at 757 et seq. Historically, however, the presumption applied to actions of private parties as well as government officials. As Justice Story said in *Bank of the United States v. Dandridge*, 25 U.S. (12 Wheat) 64, 69-70 (1827):

> By the general rules of evidence, presumptions are continually made in cases of private persons of acts even of the most solemn nature, when those acts are the natural result or necessary accompaniment of other circumstances …. [T]he law … presumes that every man, in his private and official character, does his duty, until the contrary is proved; it will presume that all things are rightly done, unless the circumstances of the case overturn this presumption ….

The presumption has been explained as a rule of evidence to avoid third party proof. As stated in *Wigmore*, it most often is applied when the matter is more or less in the past and is incapable of easily produced evidence and usually involves a mere formality or detail of procedures. 9 *Wigmore*, *Evidence* § 2534 (Chedbourn rev. 1981). The presumption has been used in government contracts, however, to favor one of the parties (the Government) in connection with contractual matters in dispute. In other words, the presumption has not been used to presume the regularity of actions by contractors' officials or employees. Examples of the presumption favoring the Government are in the following cases where it was presumed that:

(a) the reasonableness of reprocurement costs was tested, as required by regulations, *Solar Laboratories, Inc.*, ASBCA No. 19957, 76-2 BCA ¶ 12,115 at 58,197-98;

(b) the Government's deduction from payments, or withholding of payments, was because the contractor had not performed the work, *W.B.&A., Inc.*, ASBCA No. 32524, 89-2 BCA ¶ 21,736 at 109,329;

(c) payments made by the Government were correctly computed, *Maintenance Engineers*, ASBCA No. 23131, 83-1 BCA ¶ 16,411 at 81,632;

(d) the government tests were conducted properly, *Astro Science Corp. v. United States*, 471 F.2d 624, 627 (Ct. Cl. 1973);

(e) the government test results were accurate, *Tempo, Inc.*, ASBCA Nos. 37589 et al., 95-2 BCA ¶ 27,618 at 137,661-62; *C.W. Roen Construction Co.*, DOT CAB Nos. 75-43 et al., 76-2 BCA ¶ 12,215 at 58,799; and

(f) the government's method of testing was proper, *Continental Chemical Corp.*, GSBCA No. 4483, 76-2 BCA ¶ 11,948 at 57,269.

The examples above reflect the unfairness of the presumption in the Government's favor, particularly because evidence to rebut the presumption is in the Government's possession. If there is to be a presumption of regularity, it should be applied to both parties to a government contract following the Supreme Court's rule.

(2) Estoppel. The doctrine of equitable estoppel may be invoked to avoid injustice. The courts may use the doctrine to prevent a defendant from denying the existence of a contractual commitment or agreement. As stated in *Frazer v. United States*, 288 F.3d 1347, 1352-53 (Fed. Cir. 2002), the precise circumstances under which a claim of equitable estoppel is available against the Government are not completely settled. Some cases hold affirmative misconduct is a prerequisite for invoking equitable estoppel against the Government. *See, e.g., Rumsfeld v. United Techs. Corp.*, 315 F.3d 1361, 1377 (Fed. Cir. 2003).

The Federal Circuit has held that equitable estoppel may not be applied against the Government in the same way it is applied to private parties. *Zacharin v. United States*, 213 F.3d 1366, 1371 (Fed. Cir. 2000); *Rumsfeld v. United Technologies Corp.*, 315 F.3d 1361, 1377 (Fed. Cir. 2003), *cert. denied*, 540 U.S. 1012 (2003). Specifically, the court has noted that the Government will not be estopped "on the same terms as any other litigant." *Zacharin*, 213 F.3d at 1371; *Rumsfeld*, 315 F.3d at 1377.

If the Government is to be treated as a private party would be under commercial contracts, estoppel should be equally applicable to the Government.

(3) Presumption of Good Faith. There is a separate presumption of good faith apart from the "regularity" presumption. Originally, the presumption applied to private parties as well as government officials. As the court said in the *Tecom* decision:

> Quite apart from questions of "regularity," the Supreme Court had presumed the existence of good faith in a large variety of contexts. As was the case with regularity, this presumption was not particular to government officials. Private persons and institutions also enjoyed it, including purchasers of land, *Leland v. Wilkinson*, 35 U.S. (10 Pet.) 294, 297, 9 L.Ed. 430 (1836); married couples confronting accusations of bigamy, *Lieng v. Sy Quia*, 228 U.S. 335, 338-39, 33 S.Ct. 514, 57 L.3d. 862 (1913); *Gaines v. New Orleans*, 73 U.S. (6 Wall.) 642, 787, 18 L.Ed. 950

> (1867); private carriers changing their freight rates, *ICC v. Chicago Great W. Ry. Co.*, 209 U.S. 108, 120, 28 S.Ct. 493, 52 L.Ed. 705 (1908) (noting "[t]hose presumptions of good faith and integrity which have been recognized for ages as attending human action"); foreign corporations assessing shareholders for additional contributions, *Nashua Savings Bank v. Anglo-American Land, Mtge. & Agency Co.*, 189 U.S. 221, 231, 23 S.Ct. 517, 47 L.Ed. 782 (1903); and private utilities making entries in their books for rate making purposes, *West Ohio Gas Co. v. Public Utils. Comm'n.*, 294 U.S. 63, 72, 55 S.Ct. 316, 79 L.Ed. 761 (1935). Only the serious and sensational questions of bigamy and good faith in marriage seemed to place the presumption above impeachment by ordinary proof, needing instead "proof so clear, strong and unequivocal as to produce moral conviction" of the contrary. *Lieng*, 228 U.S. at 339, 33 S.Ct. 514; *see also Gaines*, 73 U.S. at 707 ("The fact of marriage being proved, the presumptions of law are all in favor of good faith. To disprove the good faith in this case there should be full proof to the contrary … the proof must be irrefragable.") (internal quotation marks and citations omitted).

66 Fed. Cl. at 760-61. In government contracts today, however, we know the presumption is applied only to acts of government officials.

There is a strong presumption that government officials act in good faith. *Torncello v. United States*, 681 F.2d 756, 770 (Ct. Cl. 1982). The presumption is so strong that, until recently, it took "well-nigh irrefragable proof" to overcome the presumption. *Kalvar Corp. v. United States*, 543 F.2d 1298, 1301-02 (Ct. Cl. 1976), *cert. denied*, 434 U.S. 830 (1977). Recently, the Federal Circuit said it takes "clear and convincing" evidence (not just a preponderance of evidence) to overcome the presumption. The presumption may be appropriate for actions of officials in the Government's *sovereign* capacity, but it should not be used to give the Government an advantage in *contractual* disputes if the Government is to be treated as other private parties. Why should it be *presumed* that government employees act in good faith but contractor employees do not?

(4) Interest as Damages. The courts have held that interest is not recoverable against the Government. *See J.D. Hedin Construction Co. v. United States*, 456 F.2d 1315, 1330 (Ct. Cl. 1972). In a recent case, the Federal Circuit held that interest is not recoverable against the Government for breach of contract even where interest was a component of price. *England v. Contel Advanced Systems, Inc.*, 384 F.3d 1372 (Fed. Cir. 2004). Judge Newman dissented in the *Contel* case, pointing out that the basic rule of sovereign immunity was not directed to "interest" but to the underlying liability and that the ancient bar to recovery of interest reflects the canonical law and common law prohibitions on usury, not the divine right of kings. She further said that sovereign immunity is not a tool of unfairness to those who do business with the Government. Therefore, if the

Government should be treated as a private person when it enters into a contract, then the Government should be liable in damages as would other parties in commercial contracts.

3. Recommendation

Section 1423 of SARA directed the Panel to review laws, regulations, and policies with a view toward ensuring effective and appropriate use of commercial practices. As discussed above, the Supreme Court consistently has stated that, when it enters the commercial marketplace, the Government is subject to the same rules that apply to private parties. It is clear, however, that the same rules are not applied to contractors and the Government. There should be, therefore, action to "level the playing field" for the Government and contractors.

A simple statutory provision could be a significant step toward leveling the field. A statutory provision could be adopted providing substantially as follows:

> Except as otherwise expressly provided by statute, the same rules of interpretation and performance of contracts and the liabilities of the parties shall be applied in the same manner to the Government and to contractors.

This provision would foster the Section 1423 goal of achieving "fair" administration of government contracts by requiring equal treatment for both parties to government contracts.

4. Supporting Arguments

Objections have been made to the recommendation on the basis that the Government needs the protection of an "unlevel" playing field to protect public funds. However, the Government already has numerous protections under various statutory provisions that give the Government enormous advantages over contractors. In addition, the Government protects itself by hundreds of contract clauses, and that contractual protection still would be available if the recommended legislation is adopted. If the existing protection is deemed insufficient, there always can be additional legislation or contract clauses to address the concern.

a. Legislative Protection. There are numerous statutory provisions that provide the Government with protections not available to contractors, and enactment of the recommended provision would not affect this protection because the recommendation clearly provides an exception for any matters expressly provided by statute. Therefore, the Government would have the protection of the following examples of such statutory protections:

Authorization and Appropriation Act limitations

Administrative Disputes Resolution Act

Armed Services Procurement Act of 1947, as amended

Anti-Kickback Act

Competition in Contracting Act

Debt Collection Act

Defense Production Act

Food and Forage Act

Forfeiture of Claims

False Claims Act

False Statement Act

Federal Property and Administrative Services Act of 1949, as amended

Misprision of Felony

Procurement Integrity Act

Suspension and Debarment ("responsible" contractors)

Truth in Negotiations Act

b. Contractual Protection. In addition to statutory protection, there are numerous standard contract clauses that protect the Government's interests. The courts will enforce these contractual protections (absent unconscionability). Indeed, parties are free to contract for any lawful purpose and with any lawful provisions, no matter how onerous or difficult it may be for one of the parties. As the Court of Claims said in *Rixon Electronics, Inc. v. United States*, 536 F.2d 1345, 1351 (Ct. Cl. 1976):

> You can engage a contractor to make a snowman in August, if you spell it out clearly, you are not warranting there will be any subfreezing weather in that month.

Examples of these contractual protections in government contracts include the following standard contract clauses:

Access to Records

Allowable Cost and Payment

Changes

Covenant Against Contingent Fees

Contract Termination – Debarment

Cost Accounting Standards

Default

Disputes

Interest

Limitation of Liability

Rights in Data

Termination for Convenience

Warranty of Supplies and Services

Withholding of Funds

(c) Conclusion. The recommended language does no more than provide statutory support for the rule of law that has been expressed by the Supreme Court and lower courts for many, many years. Adoption of the recommendation that both public and private sector members on the Acquisition Advisory Panel favor fair treatment for both parties to government contracts and have followed the SARA mandate to seek ways to apply common practices to government contracts. The proposed legislation, if enacted, would send a strong message to industry generally, and small business concerns particularly, that the Government actively is seeking to find ways to "level the playing" field by adopting commercial practices without adversely affecting the public interest.